

## Editorial Comment by: Timothy O. Kestner, VEC Economist

Leigh Thompson's article is judiciously written, intuitive, and timely. It has become commonplace to peruse most any media source and find information in regard to the economic policies of China's new ruling powers, so it is appropriate that we begin to track and report on China because of what these policies mean to the U. S. economy, and certainly how the Commonwealth may be impacted.

Just recently Zhu Zhixin, Commissioner of the National Bureau of Statistics (NBS) reported that China's GDP is expected to have increased 8 percent from 2001. This growth rate in domestic production is impressive enough, yet equally noteworthy is that this statistic is being reported from a country that once rebuked the former USSR for straying from the teachings of Carl Marx and Vladimir Lenin. Furthermore, the People's Bank of China (the central bank of China), led by the newly appointed Zhou Xiaochuan, is undertaking plans to slowly deregulate interest rates. It is clear now, given the collapse of the former Soviet Union and China's turn around, that the concept of the *command economy* is regarded as being stifling and debilitating.

Moreover, China has successfully launched and orbited the fourth in a series of unmanned rockets, and plans to launch a manned Shenzhou rocket later this year. Media sources from China report that a lunar probe is in the design stage that would lay the foundation for manned lunar exploration. These developments would make China the world's third country to place a human into space. This is yet another indicator of China's burgeoning economic potential.

As Mr. Thompson notes, the rise of the middle class (from a population of 1.2 billion) is expected to be a reality in this evolving capitalistic theater. There are two principal changes that will occur from this. Number one, there will be a negative impact on the environment on a global basis, and secondly there will be mounting competition that will induce unprecedented structural changes in the world's economies. Environmentally, one has only to envision every family in China having at least one automobile to conceptualize the resulting pollution. Surely this would bode well for manufacturing, yet serious externalities are certain as pollution will increase and tremendous pressures are placed on production resources.

It is the concept of competition that is equally disconcerting when considering the domestic impacts. China has shifted from dominating the "low-tech" goods sector to being a serious player in making and selling telecommunications, power generating and transmission equipment, aerospace, computers, furniture, and appliances. It has been estimated that 900,000 U. S. jobs will be eliminated by the year 2010, mostly impacting small manufacturing firms. The furniture industry is likely to receive the brunt of this impact as the skills of the Chinese labor force continue to be honed. In 2001, China's share of U. S. furniture imports stood at 31 percent and is estimated to double before the end of the decade.

In relation to the Commonwealth, the level of the employment impact from China's industrial growth is not known; yet the awaking of China means more competition for our industries, (especially furniture, yet also including textiles and apparel) that in the past have dominated manufacturing. Hence, we can expect their respective shares of employment to decline. However, in a positive sense and very importantly, these structural changes resulting from competition will generate enhanced opportunities for future generations of Virginians. In sum, the nascent Chinese demand economy is yet another element in an ever evolving World.

## **The Foreign Policy of China: Trends and Forecasts**

by Leigh Thompson

Sparked by Deng Xiaoping's famous maxim that "to get rich is glorious"—even in the land of Mao Tse-tung—China is on a path to becoming one of the world's great economic and political powers. Barring any political disasters, the long-term consistency of Chinese foreign policy should mean that China's rise will not be a threat to the interests of Western states, as economic interdependence has all but eliminated military belligerence as a policy option for China. The new geopolitical climate that has arisen in the wake of the terrorist attacks on New York City and the Pentagon has also produced new opportunities for cooperation between China and the United States while altering the strategic balance between China and its neighbors.

To maintain China's trajectory towards great economic and political power, Chinese policymakers will face difficult choices in every significant area of foreign policy; and economics will be a significant factor in all of those decisions. Economic opening—the liberalizing of merchandise, services, and capital flows—is the most important element in contemporary Chinese foreign policy. The restructuring taking place in the Chinese economy is causing significant changes there, and having opened itself to external economic forces, the likely economic effects of any action China takes in the international arena must now be considered.

The reforms begun under Deng Xiaoping have transformed China's economy from one of stagnating autarky to one of double-digit growth in both Gross Domestic Production (GDP) and

foreign trade as a percentage of GDP.<sup>1</sup> The Soviet-style economy instituted by Mao appears to have died with him in 1976, as two years later the progressive-minded Deng emerged as the leading figure in China's politics. He quickly began to dismantle the Maoist system of central planning, price fixing, communization, and segregation of the rural and urban populations. The reforms instituted by Deng were not in response to any severe economic crisis and unlike the "shock therapy" programs in other formerly communist states, have been implemented gradually.

China began its economic transition by freeing markets for agricultural goods and largely decollectivizing farming. Deng also pushed Chinese industry to begin importing manufacturing inputs. In turn, Chinese manufacturers started exporting their products, and the ban on foreign investment in China was lifted.<sup>2</sup> The result is that China has gone from having no foreign trade or investment to being the developing world's largest recipient of foreign direct investment<sup>3</sup> and the sixth largest importer and exporter in the world.<sup>4</sup> More recently, rules against rural-to-urban migration, along with the banning of businesspeople from membership in the Chinese Communist Party, have been lifted. Its enormous endowment of discounted labor makes China a very attractive location for foreign manufacturers looking to shift production overseas.

---

<sup>1</sup> Andrew J. Nathan and Robert S. Ross, *The Great Wall and the Empty Fortress* (New York: W.W. Norton and Company, 1997), 161.

<sup>2</sup> Dwight Perkins, "Completing China's Move to the Market," *The Journal of Economic Perspectives*, (Spring 1994).

<sup>3</sup> Marcus Noland, "China and the International Economic System," *Institute for International Economics Working Papers*, [www.iie.com](http://www.iie.com), accessed October 31, 2002.

<sup>4</sup> World Trade Organization, [www.wto.org](http://www.wto.org).

The results of its reform program have been dramatic. In the 14 years following 1978, China's Gross Domestic Product grew an average of 8 percent per year; and in 2001 the economy continued to perform well despite the economic woes facing the rest of the world.

For all of the benefits China can expect to reap from trade liberalization, there are also significant risks. As China becomes more economically interdependent with the rest of the world, it is forced to sacrifice some of its independence in foreign policy and must also contend with the influx of foreign norms and culture that inevitably accompanies an influx of foreign capital. Interdependence will also affect how China can act in approaching the twin problems of maintaining its territorial integrity and the international balance of power in East Asia.

Maintaining China's territorial integrity involves the long-term agenda of reunification with Taiwan as well as quelling the secessionist movements in the western provinces of Tibet, Xinjiang, and Inner Mongolia.

The situation in Xinjiang Province must certainly be viewed in a new light, given the changed international environment brought about by America's war on terrorism. The Chinese have long been concerned about the activity of Islamic fundamentalists in Xinjiang's Pamir Mountains and their ties to the former Soviet republics in Central Asia.<sup>5</sup> They can expect to enjoy increased freedom to act against these militants in the name of fighting terror. Given China's support of America's activities in Afghanistan and the newfound interest of the United States in greater Central Asia, China may have a unique opportunity to address its problems in

---

<sup>5</sup> Nathan and Ross, 196.

Xinjiang Province and simultaneously increase cooperation with the West on security matters.

Xinjiang is one of China's biggest producers of fossil fuels, and the United States has an interest in seeing non-Arab controlled oil from Central Asia shipped through Afghanistan. If a United States-backed regime in Afghanistan is able to consolidate power, the United States may have an economic interest in seeing the situation in Xinjiang Province stabilize and be willing to ignore the harsh measures China may feel compelled to employ there.

China's relationship with Taiwan has proved to be the most intractable of its problems with territorial integrity. As Taiwan's strategic proximity to the mainland is a genuine concern for Chinese policymakers, China must ever be wary of the possibility that Taiwan could fall under the influence of a hostile power. Additionally, it would be impossible for China to allow Taiwan to declare independence without sparking demands for similar treatment from every small group with a potential claim for regional autonomy. It may turn out, however, that Taiwan poses the greatest threat to China simply by being an economically prosperous democracy on China's doorstep. The increased contacts between mainlanders and the outside world which have been and will continue to be generated by economic integration, could stir unrest in the rising middle class on the mainland. While Chinese policymakers may fear the corrupting influence of Western norms and culture brought by economic integration, they should be most afraid of ethnic Han Taiwanese coming to the mainland and demonstrating the potential for a Chinese, capitalist, democratic state.

Maintaining a strategic balance of power with their neighbors, particularly Japan and the two Koreas, also poses problems for the Chinese. There are multiple scenarios in which a

military buildup or change in posture by any one of these states could trigger a spiraling regional arms race. China certainly has reason to favor the status quo in the region. Equilibrium has been maintained in East Asia because of the mutual fear that each nation feels for the others. Taiwan and Japan are both wary of China's growing military and economic strength, but both China and Taiwan have historical reasons to fear a strong Japan. A change in the pariah status of North Korea's Kim Jong-Il would be a concern for China as it could lead South Korea to move production away from China's cheap labor to North Korea's even cheaper labor.<sup>6</sup>

In light of America's new focus on fighting terrorism and preventing the proliferation of weapons of mass destruction, the position of North Korea has become more tenuous. China now must face the likelihood of increased tensions between North Korea and the United States. Whether the United States chooses to act militarily against North Korea or not, there will be increased maneuvering on the part of the United States to excise this limb of the "axis of evil." China should pressure Kim to cooperate with the West on eliminating his missile programs and try to use its position as Kim's only friend to gain early access to North Korean markets. The Chinese may not prefer a change in the status of North Korea, yet to the extent that such a change is likely in the long-run, they should plan to make any changes conform to Chinese interests. Additionally, this is another area in which China could potentially increase its cooperation with the West in maintaining the international order. By helping to bring North Korea into the fold of "normal" states, China could further ensconce its own status as one of them.

---

<sup>6</sup> Ibid., 97.

China has further established itself as a part of the “club” of world politics by joining the World Trade Organization. Nonetheless, the continued suppression of the Falun Gong sect (a quasi-religious group banned by Beijing) and the interest this situation has provoked in lawmakers in the United States has kept the spotlight trained on China’s human rights policies. As mentioned above, America’s new focus on terrorism should give the Chinese a freer hand in dealing with dissidents in the western provinces. Economic integration however, and the multinational corporations in China may force some policy changes on the Chinese. The extent to which multinational corporations will get involved with China’s human rights policies remains to be seen. In some industries, such as sneaker and soccer ball sewing sweatshops, multinationals have been pushed by interest groups to press for reform in the countries in which they contract for labor. On the other hand, in near-failing states like Nigeria, international oil companies have done nothing to promote human rights, preferring to hire private security to protect their capital investments and nothing more.

Regardless of the role that foreign business plays in the human rights policies of China, it seems likely that the Chinese have, like it or not, embarked on an irreversible path not only away from economic socialism, but quite possibly toward democracy. While the road to democracy may be long and slow, it may prove to be extremely successful for just that reason. Many theorists argue that as a country develops economically, as China undeniably is, it begins to develop a middle class. This is particularly likely to happen in authoritarian states where socially difficult, economically sensible decisions can be made by a central power. As the middle class becomes richer and more established, it is argued, they will eventually demand more accountability from the government—in other words, democracy. Many would argue that at this

stage of development a country has two choices: democratize or reverse economic progress and destroy the middle class.

This pattern of democracy arising as a consequence of economic development is roughly an accurate description of recent events in South Korea and Taiwan. It therefore behooves Chinese officials to pay close attention to the fate of the authoritarian regimes in countries like Singapore and Malaysia in coming years to see if economic development in those states follows the pattern and leads to democracy. Further, the possibility of such a scenario validates the emphasis placed by Chinese authorities on territorial integrity. Were democracy to spring up spontaneously in China today, the country would possibly not survive as a unified territorial entity (as was the case in the former Soviet Union, Yugoslavia, Czechoslovakia, etc.); hence, China must enshrine a sense of adherence to the state in its breakaway provinces.

In short, the very slow process of economic transformation started by Deng may prove to be the only feasible means of developing—both economically and politically—a country so huge and diverse as China. There is much to say in favor of the current trend of Chinese foreign policy and its direction is unlikely to change with the November 2002 installation in of Hu Jintao as the new Communist Party leader. It will likely continue to be characterized by consistency and, if properly managed by the West, should not be viewed as a threat to Western interests. In light of the newfound emphasis on terrorism in United States foreign policy and the further integration of China into the world economy, it is increasingly likely that China will be able to rise to the status of a great power and participate as a “normal” nation in international relations.



